Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Sandwich Isles Communications, Inc.	)	
	)	
Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary and Sections 36.611, and 69.2(hh) of the Commission's Rules	))))	CC Docket No. 96-45

HAWAIIAN TELCOM COMMUNICATIONS, INC.
APPLICATION FOR REVIEW

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SUMMARY

On May 16, 2005, the Wireline Competition Bureau (the "Bureau") issued an order on delegated authority that granted a Petition for Study Area Waiver filed by Sandwich Isles Communications, Inc. ("SIC") so SIC could receive support in certain areas based on its own costs, as if it were an incumbent local exchange carrier ("ILEC"). On behalf of Hawaiian Telcom, Inc., the actual ILEC in the affected areas, its parent Hawaiian Telcom Communications, Inc. (with Hawaiian Telcom, Inc., "Hawaiian Telcom") submits this Application for Review to urge the Commission to reverse the Bureau's Order.

The Bureau's Order failed to give adequate weight to numerous facts in the record that call into doubt whether grant of the Petition would serve the public interest. For example, the Bureau ignored evidence that the Hawaiian Home Lands ("HHL") were served by Hawaiian Telcom at the time of the Petition. Indeed, even today, Hawaiian Telcom serves more customers in the HHL than SIC. The Bureau also gave scant consideration to evidence that a grant of the waiver would have an adverse effect on the universal service fund or that SIC intended to use the support for purposes for which it is not intended, in violation of Section 254 of the Communications Act of 1934, as amended (the "Act"). Moreover, the Bureau declined to clarify critical issues raised by its grant of SIC's Petition, such as the exact geographic area covered by the study area waiver and Hawaiian Telcom's status within the HHL. It is imperative that the Commission confirm that Hawaiian Telcom retains the right to serve the HHL, including the areas within the HHL that it historically has served. Because of the novelty of the far-reaching issues raised by the SIC Petition, it is questionable whether the Bureau properly acted on delegated authority.

In addition to inadequately addressing evidence on the record, the Bureau's decision is inconsistent with applicable legal precedent. In particular, the Bureau did not incorporate into its analysis Commission policy regarding growth in the rural high-cost fund. In determining that the public interest would be served by grant of the requested waivers, the Bureau did not consider the costs to the public and instead looked only at the predicted benefits of continued federal funding to SIC. Hawaiian Telcom does not dispute that federal funding may spark investment in the HHL, but the Bureau's Order lacks any consideration of the fact that Hawaiian Telcom has been obligated to serve the HHL *without* federal support. The Bureau's Order effectively strips Hawaiian Telcom of part of its service territory in favor of providing extremely high subsidies to a start-up company with questionable long-term intentions. The Bureau's Order creates a dangerous precedent, and should be overturned.

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I. INTRODUCTION

Pursuant to Section 1.115 of the Commission's rules, 47 C.F.R. § 1.115, Hawaiian Telcom Communications, Inc. f/k/a Hawaiian Telcom MergerSub, Inc. f/k/a Paradise MergerSub, Inc., on behalf of its incumbent local exchange carrier ("ILEC") subsidiary, Hawaiian Telcom, Inc. f/k/a Verizon Hawaii Inc. (together, "Hawaiian Telcom") submits this Application for Review of the Order issued by the Wireline Competition Bureau (the "Bureau") in the above-captioned proceeding.[1]

In its Order, the Bureau granted Sandwich Isles Communications, Inc. ("SIC") a study area waiver so that for certain customers in parts of Hawaiian Telcom's statewide study area known as the Hawaiian Home Lands ("HHL"), SIC will be treated as the ILEC solely for universal service purposes, and receive support based on its own costs.

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[1] *Sandwich Isles Communications, Inc., Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary and Sections 36.611, and 69.2(hh) of the Commission's Rules*, Order, CC Docket No. 96-45, DA 05-1355 (Wireline Comp. Bur. rel. May 16, 2005) ("Order").

The HHL are non-contiguous areas divided among six Hawaiian islands. Although the HHL would meet the Commission's definition of "high-cost" as a standalone study area, Hawaiian Telcom historically has not been eligible for federal high-cost support for serving the HHL because the statewide Hawaii study area is considered non-rural and does not qualify for support under the rules governing non-rural high-cost support. In 1998, the Bureau granted SIC, a new company, a waiver of Section 36.611 of the Commission's rules so that SIC could receive high-cost funds based on its own costs, rather than the costs of the ILEC, then GTE Hawaiian Telephone Company, Inc.[2] The Bureau based this decision on its finding that the HHL were largely "unserved."[3] On March 5, 1998, GTE timely filed an Application for Review.[4]

More than six years later, the Commission reversed the Bureau because the Bureau had ignored evidence that the HHL were, in fact, served by Hawaiian Telcom.[5] The Commission acknowledged that it had taken several years to address the issue on reconsideration and permitted SIC to continue receiving support, but ordered SIC to file a petition for study area waiver in order to maintain its eligibility to receive federal universal service support.[6] On delegated authority, on May 16, 2005, the Bureau granted SIC's Petition.[7]

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2 *In the Matter of Sandwich Isles Communications*, Order, 13 FCC Rcd 2407, ¶ 1 (1998).

3 *Id.* at ¶ 10.

4 GTE Hawaiian Telephone Company, Incorporated, Application for Review of an Order Granting in Part a Petition of Sandwich Isles Communications, Inc., AAD 97-82 (filed Mar. 5, 1998) ("GTE Application for Review").

5 *In the Matter of GTE Hawaiian Telephone Company, Inc. Application for Review of a Decision by the Common Carrier Bureau*, Memorandum Opinion and Order, AAD 97-82, 19 FCC Rcd 22268, ¶ 7 (2004) ("*Order Granting Application for Review*").

6 *Id.* at ¶ 10.

7 Order at ¶ 1.

Hawaiian Telcom submits this Application for Review because the Bureau's Order should be reversed under the standards set forth in the Commission's rules.[8] The Bureau's order failed to adequately address numerous facts presented in the record and improperly applied Commission precedent to the record in the proceeding. Moreover, the SIC Petition raised several novel questions of law and policy that deserve the full Commission's consideration. Each of these standing alone would be sufficient basis for Commission review and reversal of the Bureau's Order. If the Commission does not reverse the Bureau's Order, Hawaiian Telcom respectfully requests that the Commission clarify the regulatory status of Hawaiian Telcom and SIC in the HHL. In particular, the Commission should specify the geographic scope of the areas within which SIC is to receive universal service support based on its own costs, confirm that Hawaiian Telcom retains the right to continue to serve those areas, and clarify Hawaiian Telcom's status in those areas as an ILEC or a CLEC.

II. THE BUREAU'S ORDER COULD CAUSE SUBSTANTIAL INJURY TO HAWAIIAN TELCOM; THEREFORE, HAWAIIAN TELCOM HAS STANDING TO SEEK REVIEW

As a party to the above-captioned proceeding that was "aggrieved" by the Bureau's Order, Hawaiian Telcom has standing to file this Application for Review, pursuant to Commission rules.[9] As the Bureau recognized, however, Hawaiian Telcom was constrained in its initial comments due to the pending acquisition of Verizon Hawaii Inc. by Hawaiian Telcom.[10] With the acquisition imminent, Verizon expended minimal resources in this

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[8] 47 C.F.R. § 1.115 (setting forth the specific grounds appropriate for review).

[9] 47 C.F.R. § 1.115(a); *see* Order at ¶ 13 (recognizing that Hawaiian Telcom submitted comments and identified several concerns with SIC's petition for waiver).

[10] Order at n.46.

proceeding,[11] while Hawaiian Telcom was not yet in a position to fully acquaint itself with the facts surrounding the Petition.[12] Nevertheless, Hawaiian Telcom raised a number of serious concerns about the SIC Petition and documented several inconsistencies in SIC's statements.

Hawaiian Telcom has standing to bring this Application for Review because the Bureau's grant of the SIC Petition will adversely affect Hawaiian Telcom. First, by regulatory fiat, the Bureau appears to have stripped Hawaiian Telcom of approximately 203,500 acres of its study area despite the Commission's prior holding that Hawaiian Telcom has the right to serve this area as the ILEC.[13] This was done without a hearing or any finding that Hawaiian Telcom or its predecessor had failed to provide service upon request. In contrast to the present case, in the past proceedings cited in the Bureau Order,[14] the ILECs supported the respective applicants' petitions for study area waivers. In the vast majority of cases, a request for study area waiver followed an ILEC's sale of a partial study area,[15] and the valuation of the property is based in

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[11] *See generally* Comments of Verizon. Verizon's comments were only two pages long. *Id.*

[12] Order at n.46.

[13] *Order Granting Application for Review* at ¶ 9, n.34.

[14] *M&L Enterprises, Inc. d/b/a Skyline Telephone Company, Petition for Waiver of Sections 36.611, 36.612, and 69.2(hh) of the Commission's Rules*, Order, 19 FCC Rcd 6761 (2004) ("*Skyline Order*"); *US West Communications, Inc. and Eagle Telecommunications, Inc.*, Order, 10 FCC Rcd 1771 at ¶¶ 1, 7, 11 (1995) ("*PTI/Eagle Order*").

[15] *See PTI/Eagle Order* at ¶¶ 1, 7, 11 (1995) (involving the sale of 43 exchanges from US West to PTI/Eagle); *CenturyTel of Central Wisconsin, LLC and GTE North Incorporated*, Order, CC Docket No. 96-45, DA 00-1863 (rel. Aug. 16, 2000) (involving the sale of 42 exchanges from GTE to CenturyTel); *Pioneer Telephone Cooperative, Inc., Panhandle Telephone Cooperative, Inc., EagleNet, Inc.*, Order, CC Docket No. 96-45, DA 01-659 (rel. Mar. 19, 2001) (involving the sale of 14 exchanges from GTE Southwest Incorporated to EagleNet, PTCI and Pioneer) ("*Pioneer Order*"); *Federal-Joint Board on Universal Service Blackduck Telephone Company and Arvig Telephone Company*, Order, CC Docket No. 96-45, DA 02-3368 (rel. Dec. 6, 2002) (involving the sale of 116 access lines from Arvig to Blackduck) ("*Blackduck Order*"); *Searsboro Telephone Company, Inc. and Killduff Telephone Company*, Order, CC Docket No. 96-45, DA 04-2258 (rel. July 27, 2004) (involving the sale of 190 access lines from Searsboro to Killduff) ("*Killduff Order*").

part on receipt of support by the buyer.[16] In the present case, there was nothing consensual about SIC's displacement of Hawaiian Telcom in the HHL. To the extent that grant of the SIC Petition revokes Hawaiian Telcom's role as the ILEC in the HHL, this action was simply taken without any consideration of compensation to Hawaiian Telcom for investment it has made there.[17] If Hawaiian Telcom still is authorized to serve the HHL, as an ILEC or a CLEC, that should be explicitly stated by the Commission upon review.

Second, the Bureau's decision may place Hawaiian Telcom at a competitive disadvantage because of SIC's intentions to use its network to serve non-rural parts of the state, including certain areas within the HHL, which are heavily developed. It must be noted that not all HHL are remote. Some of the HHL are located in urban areas served by Hawaiian Telcom. In several instances, Hawaiian Telcom customers have been informed that they *must* use SIC, resulting in Hawaiian Telcom ceasing service to HHL customers. For example, in urban Honolulu, near the University of Hawaii, the HHL include commercial property formerly served by Hawaiian Telcom. There are no facilities-related impediments for continued service by Hawaiian Telcom. However, as a result of SIC's claim of exclusive service to all of HHL, Hawaiian Telcom recently was instructed by the HHL that Hawaiian Telcom must use SIC's services on that property if Hawaiian Telcom were to lease the property from HHL for its own business purposes. There are other similar cases in which SIC's claims of exclusivity have prevented Hawaiian Telcom from serving customers in urban areas traditionally served by the

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[16] *See, e.g., PTI/Eagle Order* at ¶ 16 (recognizing that the "the parties negotiated this complex transaction and filed their petition for waiver on the reasonable expectations" that the waiver would be granted).

[17] *C.f. Penn Central Transportation Company v. City of New York*, 438 U.S. 104, 124-125 (1978) (determining whether a taking has occurred by balancing the character of the government action, the economic impact of the action and the extent to which the action interferences with investment-backed expectations).

ILEC. In addition, SIC's statement to the Commission that it is not authorized to provide service beyond the HHL is disingenuous and misleading. By its own admission, SIC already has set up a CLEC affiliate in Hawaii for the very purpose of serving customers beyond HHL, and intends to use the federally subsidized SIC network to do so.[18]

Either taking part of Hawaiian Telcom's study area without any compensation to Hawaiian Telcom or subsidizing competition outside of the HHL would materially harm Hawaiian Telcom. Based on its earlier participation in this proceeding and the potential substantial injury posed by the Bureau's Order, Hawaiian Telcom has standing to seek review of the Bureau's Order.

III. THE BUREAU'S ORDER FAILS TO ADEQUATELY ADDRESS THE CONCERNS RAISED IN THE RECORD AND DIVERGES FROM ESTABLISHED PRECEDENT

The Commission should reverse the Bureau's Order because the Order overlooks substantial evidence on the record that a grant of the SIC Petition does not serve the public interest. Among other things, the Order includes several erroneous findings as to material questions of fact and is in conflict with established case precedent and Commission policy, both of which are grounds for reversal under the Commission's rules.[19] The Bureau Order also dealt with novel questions of law and policy that will have a wide-ranging and a long-term impact on universal service and the public interest.[20] It is questionable whether the Bureau had authority to

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[18] *See* Comments of Hawaiian Telcom at 13 (quoting Carleen Hawn, *Dreaming & Scheming Hawaiian Style*, FORBES MAGAZINE, Oct. 11, 2002 (available at http://www.forbes.com/forbes/2002/1028/172.html) ("Forbes Article")).

[19] 47 C.F.R. §§ 1.115(b)(i), (iv).

[20] *Id.* § 1.115(b)(ii).

decide these issues.[21] Furthermore, in certain instances, the Bureau followed certain precedent that requires Commission review due to the unusual factual circumstances surrounding the evolution of Commission policy and the factual backdrop related to the federal universal service fund.[22]

In Section III.A, this Application for Review focuses on the factual issues that the Bureau's Order did not adequately address. In Section III.B, Hawaiian Telcom discusses the Order's errors in applying established Commission precedent to the facts established in the record.

A. The Bureau Order's Failure to Address Material Record Evidence Constitutes Reversible Error

1. The HHL are not "unserved"

In the Order, the Bureau erroneously found, "[T]he record is clear that GTE was not offering service throughout much of the Hawaiian home lands."[23] In fact, the Commission overturned the Bureau's 1998 order for the very reason that Hawaiian Telcom's predecessor entity served the "proposed areas" and "*[t]hese facts were material* to the Bureau's decision to grant Sandwich Isles' request for waiver…."[24] The Commission emphasized that an area is not "unserved" as a matter of law if it is within the study area of another carrier.[25]

The record presented to the Bureau also demonstrates that Hawaiian Telcom provides service to the HHL as a matter of fact. That the HHL have been part of the study area

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[21] *Id.* at § 0.291(a)(2) ("The Chief, Wireline Competition Bureau shall not have authority to act on any applications or requests which present novel questions of fact, law or policy which cannot be resolved under outstanding precedents or guidelines").

[22] *Id.* § 1.115(b)(iii).

[23] Order at ¶ 21.

[24] *Order Granting Application for Review* at ¶ 7 [emphasis added].

[25] *Id.* at ¶¶ 8-9.

of Hawaiian Telcom and its predecessors, Verizon Hawaii Inc. and GTE Hawaiian Telephone Company, Inc, is evidenced by the availability of a tariffed product offering throughout the HHL even prior to SIC's existence. Even today, Hawaiian Telcom serves more customers in the HHL than SIC. At the time of SIC's original petition, GTE was already providing service to parts of the HHL,[26] building out capacity to provide service to HHL residents,[27] and capable of serving potential HHL customers from some of the largest central offices in the state of Hawaii.[28] The DHHL approached GTE to request service for portions of the HHL under the existing tariff and GTE offered to provide such service.[29]

SIC acknowledges these facts in its Petition,[30] and it has previously acknowledged that it was impossible for GTE to "fail" to provide service in the areas of the HHL subject to the original proceeding because these areas were undeveloped and service had not been requested.[31] If any qualified Hawaiian resident moved to the HHL and requested service, the Hawaiian

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26 *See infra* note 31.

27 Sandwich Isles Supplement, In the Matter of Sandwich Isles Communications, Inc., AAD 97-82 (filed June 1, 1998) ("Sandwich Isles' Supplement") at Attachment C (Letter from Kali Watson, Chairman, Hawaiian Homes Commission, to Jon Uyehara, Manager, Infrastructure Provision Department, GTE-Hawaiian Telephone (May 20, 1998) (demanding that GTE remove overhead lines that it had installed in an HHL subdivision undergoing construction)).

28 GTE Application for Review at 9; Opposition of GTE, In the Matter of Sandwich Isles Communications, Inc., AAD 97-82, at 7 (filed Sept. 15, 1997) ("Opposition of GTE").

29 Reply to Late-Filed Comments and Opposition, In the Matter of Sandwich Isles Communications, Inc., AAD 97-82, Exhibit 2, Affidavit of Michael Crozier (filed Oct. 2, 1997) (stating that DHHL was receiving phone service at the time of DHHL's residential development of HHL located in Maku'u and that GTE offered to provide single-party service for this region of HHL).

30 *See, e.g.,* Petition at n.32 ("Sandwich Isles waiver request did not include those few small portions of the HHL where GTE was then providing service to actual subscribers."); Sandwich Isles Supplement at notes 5-7; Order Granting Application for Review at ¶ 9; Opposition of GTE at 5-8 (discussing the areas of the HHL that were served by GTE).

31 Sandwich Isles' Supplement at 2 ("The areas that are the subject of the Sandwich Isles petition are undeveloped and, by definition, unserved.").

Administrative Rules required GTE (and now require Hawaiian Telcom), as the carrier of last resort, to provide service upon request.[32] Similarly, the federal Communications Act requires common carriers to provide service upon reasonable request.[33] Therefore, under both state and federal law, GTE was under an obligation (as Hawaiian Telcom is today) to provide service to any HHL resident upon request and SIC has failed to show that Hawaiian Telcom is unable or unwilling to fulfill this obligation.

Any allegations that Hawaiian Telcom is not or has not always been ready, willing and able to provide service to the HHL is contrary to the established facts. For instance, SIC's claims that Hawaiian Telcom did not really serve the HHL because it required payment for facilities construction is disingenuous.[34] Hawaiian Telcom is required to non-discriminatorily apply its tariffs and rules as a regulated public utility. Those rules and tariffs require customer contributions as a condition of service, depending upon the facts presented. In addition, the economics of providing telecommunications services to the HHL, as well as other similar geographic areas, demand that any service provider offering service to HHL condition such service on the receipt of compensation. Hawaiian Telcom must rely on the customer requesting service to provide payment for facilities (or DHHL if it is the entity requesting service). In stark contrast, SIC requires universal service support payments to build out its network to provide services to the HHL. SIC's current and future services are expressly conditioned on SIC's receipt of almost $14,000 per line per year, otherwise, in the Bureau's words, SIC will offer

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32 Hawaii Administrative Rules §§ 6-81-4, 6-81-8, 6-81-54 (available at www.hawaii.gov/budget/); Hawaii Revised Statutes § 269-7.5(c) (available at http://www.capitol.hawaii.gov/site1/docs/docs.asp?press1=docs).

33 47 U.S.C. § 201(a).

34 Petition at 14.

"unaffordable rates in the Hawaiian home lands" and there will be "a serious risk of default on [SIC's] RUS loans."[35]

Moreover, *much of the HHL remain unserved because they are unpopulated*. While SIC has built out to certain actual customers, the majority of its expansion and its investment of federal monies have been devoted to not-yet-occupied lots.[36] It is not surprising that GTE/Verizon could not afford to build facilities to vacant properties. SIC's commitment to build out to the entire HHL (whether people live there or not) will only ensure greater and greater federal funding for the HHL, but the benefit to universal service is unclear.

If the HHL are considered unserved by Hawaiian Telcom despite Hawaiian Telcom's willingness and ability to provide service where and when requested, then the Commission must conclude that SIC also leaves much of the HHL "unserved." As SIC conceded years ago, the areas it originally proposed to serve were "in the vicinity of existing GTE facilities"[37] and therefore SIC left much of the HHL similarly "unserved." SIC still does not currently have the infrastructure to provide immediate service on request to the vast majority of locations within the HHL. Most of the HHL remain undeveloped, uninhabited and incapable of receiving service from SIC – hence, "unserved" using the Bureau's logic.

2. HT showed that a grant of the SIC petition would have over a one impact on the universal service fund

Grant of a study area waiver will drain over one percent of universal service funds on an annual basis due to: (a) SIC's stated future plans and the future plans of DHHL to provide

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35 Order at ¶ 12, n.53.

36 Letter from David Cosson, Counsel to SIC, to Marlene Dortch, Secretary, FCC (April 25, 2005) (stating that SIC currently has facilities passing 4,300 lots, which is much greater than the 1,238 lines that SIC currently serves).

37 Reply to Late-Filed Comments and Opposition, by Sandwich Isles Communications, Inc. at 5 (filed Oct. 2, 1997).

service to a rapidly increasing population on the HHL; and (b) CETCs who, if the petition is granted, will seek support based on the amount of support to which SIC is entitled.

One of the primary public interest benefits that the Bureau emphasized in granting SIC's Petition was the provision of service to a rapidly expanding customer base. The Bureau wrote:

> Sandwich Isles currently has telecommunications facilities passing 4,300 lots on the Hawaiian home lands and expects to pass another 1,500 lots over the next two years. Sandwich Isles expects to have approximately 1,700 subscribers by the end of this year, and approximately 4,600 subscribers by the end of 2009.[38]

The Bureau estimates that the impact of SIC on the fund is about 0.42 percent this year.[39] Given the above growth estimates and all else being equal, SIC's direct total annual support costs will increase from 0.42 percent to 0.58 percent of the fund by year-end, and to 1.58 percent of the fund by the year 2009.[40]

In addition, with issuance of their Order, the Bureau consented to at least *two companies* receiving universal service support for services provided in the HHL: SIC and NPCR, Inc. Prior to the Order, NPCR received support based on SIC's per-line support amounts. After grant of the waiver, it will continue to do so. To the extent SIC's per-line support continues to increase, so will NPCR's. NPCR adds an additional 0.31 percent to projected high-cost support and this raises the current impact on the universal service fund to

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[38] Order at ¶ 19 (citations omitted).

[39] Order at n.53.

[40] Assuming, as the Bureau does, that SIC will have 1,700 subscribers by year end and 4,600 subscribers by the end of 2009 (0.58% = 0.42% x (1700/1238) and 1.58% = 0.42% x (4600/1238)). These estimates are likely low given that SIC's per line costs have risen steadily from quarter to quarter and year to year.

0.74 percent (aggregating both SIC's and NPCR's impact).[41] This impact likely will increase to at least 0.89 percent by year end;[42] the impact will be greater if NPCR continues to grow its number of lines. The Bureau provided no explanation for its decision to ignore the funding that will immediately flow to NPCR.[43]

The Bureau's failure to weigh the real costs of granting SIC's petition along with the purported benefits is a reversible error. As already noted, the Bureau emphasized the projected rapid growth of SIC's subscriber base as one of the primary public interest benefits of granting a waiver. This growth in HHL subscribers may have occurred without SIC because Hawaiian Telcom remains willing and able to serve the areas currently served by SIC. But despite counting this expected growth as a benefit, the Bureau erroneously excluded it in calculating the cost of SIC's Petition to the universal service fund.[44] Such accounting is out of line with the development of sound regulatory policy based on economic principle.[45]

3. The Bureau ignored record evidence that SIC is improperly using federal support for purposes for which it was not intended

Hawaiian Telcom also provided evidence on the record that SIC is using support improperly, but the Bureau Order completely ignores this evidence. As discussed in Hawaiian Telcom's comments, Section 254 of the Act requires the Commission to ensure that federal support is used for the purpose for which it is intended, namely, providing local exchange

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41 *See* USAC Quarterly Administrative Filing 2005, Third Quarter (3Q) Appendices, HC01, filed May 2, 2005, at http://www.universalservice.org/overview/filings. (0.31% = $3.18 million / $1,019 million).

42 This estimate aggregates SIC's projected impact on the fund for year end (0.58 percent) with NPCR's current impact on the fund (0.31 percent).

43 Order at ¶ 17.

44 *Id.*

45 RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 397 (6th Ed. 2003) ("The basic tool of regulation conducted in accordance with economic principles is cost-benefit analysis").

services enumerated by the Commission as eligible support.[46] Officers in SIC's organization openly have discussed their wish to use universal funding in part to build a long-haul fiber network to serve customers outside of the HHL – in other words, to serve low-cost customers using high-cost funds. For example, Gil Tam, an SIC vice president for government and community relations, stated that the system actually is intended for eventual use by the general public, high-tech businesses throughout the state of Hawaii (not just on HHL), and possibly the military.[47] Public statements by Al Hee, president of SIC, indicate SIC intends to undercut Hawaiian Telcom on price in other markets by providing switching support to a CLEC affiliate, ClearCom, over SIC's HHL network, built with universal service funds. Specifically (as was referenced in Hawaiian Telcom's Comments in this proceeding):

> ClearCom will use SIC's central switching offices to link the communications traffic of urban customers to the public network. Because for at least the first few years ClearCom won't have to pay SIC for access, [Al Hee] figures he can undercut incumbent rivals on price.
>
> […]
>
> So Al Hee uses government subsidies to build a telecom network for rural consumers and parlay it into profits by serving urban residents and businesses. This irritates his detractors, but he doesn't flinch. "My [SIC] license is dependent upon providing service to the Home Lands. As long as I do that, I'm good. Worst-

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[46] Comments of Hawaiian Telcom MergerSub, Inc., CC Docket No. 96-45, at 12 (filed Feb. 8, 2005).

[47] *Id.* at 12-13; *See* Valerie Monson, *Burial Counsel questions need for fiber optic system*, THE MAUI NEWS, April 27, 2001 (available at http://www.the-catbird-seat.net/SandwichIsles.htm) ("Tam finally acknowledged that the general public will be the major subscribers of the project. After the meeting, he admitted that the users might include the military," and quoting Tam, "'Anybody could' end up paying to tap into the network, he said."); Anthony Sommer, *Fiber-optic firm taps federal gold mine, A Hawaii company will get $500 million to lay a rural network that may see little use*, HONOLULU STAR-BULLETIN, June 4, 2002 (available at http://starbulletin.com/2002/06/04/news/story2.html) (quoting Tam, "I think it is clear to everyone that we need a first-class infrastructure to attract high-tech businesses to Hawaii and our mission is to build that infrastructure on Hawaiian Home Lands[.]").

> case scenario, someone sues and it takes 10 to 15 years to work through the courts. By then my network will be built. Will they then tear it up? No way."[48]

The Bureau apparently overlooked these facts when it found, "no evidence in the record to support Hawaiian Telcom's claims of improper use of the funds.[49] The Bureau further stated, "Specifically, we note that the Hawaii Commission has certified annually, since such certification was required, that Sandwich Isles is using its support in accordance with section 254(e) of the Act." However, the Commission may not simply take the state's word and ignore contrary evidence. Under the statute, the Commission has a duty to ensure that that funds are being used for their intended purpose.[50] Statements made by senior SIC officers provide evidence sufficient to justify further inquiry into the use of these funds.

4. The Bureau erred in declining to address Hawaiian Telcom's status related to its existing customers and future customers in the HHL

The Bureau declined to resolve two material issues raised in this proceeding relating to Hawaiian Telcom's ability to do business in HHL: (1) the geographic boundaries of Hawaiian Telcom's remaining study area; and (2) Hawaiian Telcom's rights and responsibilities with respect to HHL customers and services. Failure to resolve these issues creates substantial uncertainty for the HHL, exposes Hawaiian Telcom to future risk of litigation and could result in diminished service to HHL customers affected by the Order.

One of the most basic flaws with the Order is that it never sets forth the exact contours of the areas subject to the study area waiver grant. The Bureau found, "[T]he study area we grant herein should be limited to only those areas where there were no facilities or

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[48] Comments of Hawaiian Telcom at 13; Forbes Article *supra* note 12.

[49] Order at ¶ 25.

[50] 47 U.S.C. § 254(e).

service on the Hawaiian home lands in 1997, *i.e.,* the areas that Sandwich Isles claimed were unserved in its 1997 Petition."[51] But the areas without facilities or service in 1997 and those subject to SIC's petition were never definitively identified. In fact, Sandwich Isles amended the scope of its Petition on at least one occasion.[52] Moreover, SIC suggested that its original Petition covered only "those portions of the Hawaiian Home Lands which currently are unserved *and will be receiving initial local service from Sandwich Isles*."[53] "Initial service" by SIC arguably was limited to a small subset of the customers SIC serves today. The relevant service areas were never defined in 1997, and they are left undefined in the wake of this Order.

The Bureau created even more confusion by declining to resolve the issues Hawaiian Telcom raised under Sections 253 and 251(h)(2) of the Act.[54] Historically, Hawaiian Telcom has been the ILEC and carrier of last resort for the State of Hawaii, including the HHL. The Order apparently carved out a portion of the HHL from Hawaiian Telcom's existing study area to create a new study area for SIC, but declined to decide (a) whether Hawaiian Telcom is entitled to continue to provide service in the HHL regardless of DHHL's purportedly "exclusive" license to SIC, or (b) whether anyone is the ILEC or carrier of last resort in SIC's new study area.

The Bureau declined to classify SIC an ILEC pursuant to 251(h)(2), but refused to consider whether SIC enjoys an exclusive franchise in violation of Section 253. If Hawaiian Telcom is entitled to provide service in the HHL, and the purportedly exclusive license granted by DHHL is void under Section 253, then is Hawaiian Telcom now a CLEC entitled to receive

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[51] Order at ¶ 15 (citation omitted).

[52] Sandwich Isles Supplement at nn.5-7 (acknowledging that the Princess Kahanu, Shafter Flats and Kapalama areas of the HHL were erroneously included in SIC's 1997 Petition).

[53] *Id.* at 1 [emphasis added].

[54] Order at ¶ 23 and n.89.

universal support based on the amount SIC receives? Are both carriers CLECs in the new study area? Can SIC receive the benefits of ILEC classification only for the limited purpose of receiving universal service funding, while Hawaiian Telcom bears the burden of being the carrier of last resort and ILEC for other purposes, *e.g.*, retaining interconnection obligations? On the other hand, if the SIC franchise is exclusive, is the FCC preempting the state's previous designation of Hawaiian Telcom and its predecessor as ILEC and carrier of last resort? What is Hawaiian Telcom's remaining obligation toward its customers in the HHL?

The Bureau created substantial confusion with respect to these important issues by declining to address them. This state of affairs likely will result not only in disputes between SIC and Hawaiian Telcom, but could diminish the quality of service to customers in the HHL. Neither SIC nor any other carrier should receive the benefits of incumbent LEC status without bearing the concomitant burdens thereto. In any event, these are questions of first impression that the Commission should address.

B. The Bureau's Order Conflicts with Well-Established Commission Policy Underlying the Study Area Boundary Freeze

The policy underlying the Commission's study area boundaries is "to prohibit companies from setting up high-cost exchanges within existing territories as separate study areas to maximize support."[55] As the Bureau noted, the Commission has applied a three-prong standard in determining whether to waive its study area freeze: (1) the change in study area boundaries must not adversely affect the universal service fund; (2) the state commission having regulatory authority over the transferred exchanges must not oppose the transfer; and (3) the transfer must serve the public interest.[56] The Bureau erred in its application of this test to the

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[55] *Order Granting Application for Review* at ¶ 8.

[56] Order at ¶ 8 (citing *PTI/Eagle Order* at ¶ 5; *Skyline Order* at ¶¶ 14-18).

record in this proceeding. Grant of the SIC Petition will have an adverse affect on universal service and disserve the public interest.

1. Grant of the waiver adversely affects universal service

Under Commission precedent, SIC must show that a grant of the requested study area waiver will not adversely affect the universal service fund. The Commission has set a one percent threshold for determining whether the impact of the proposed study area waiver is such that a grant would require a higher showing – "an extraordinary public interest benefit."[57] As explained above, Hawaiian Telcom demonstrated that a grant of the SIC Petition would have an *immediate* impact of 0.74 percent of the fund (including SIC and NPCR), and that the impact of the waiver would soon grow to well over one percent. The Bureau's findings that the waiver would not adversely affect the fund thus were erroneous.[58]

The recent growth in CETC funding also demands reconsideration of the Bureau's failure to take into account evidence that future CETC funding would cause the impact of the waiver to exceed the one percent threshold.[59] The *PTI/Eagle Order* on which the Bureau so heavily relies was drafted at a time when there were no CETCs. It is no surprise that the order did not take funding to competitors into account in making its calculation. The principle

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57 *In the Matter of US West Communications, Inc. and Eagle Telecommunications, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary of the Commission's Rules*, Memorandum Opinion and Order on Reconsideration, 12 FCC Rcd 4644, ¶ 1 (1997).

58 *See supra* Section III.A.2.

59 *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, Public Notice in CC Docket 96-45, FCC 04J-2 (rel. Aug. 16, 2004) (considering, among other things, proposals to mitigate the growth in the universal service fund caused by proliferation of CETCs). As explained in a 2004 Legg Mason report, "*the size of the universal service fund . . . would not be a major concern if it were not for the dramatic growth in CETC payments over the last two years and the potential expansion in the next few years*." Legg Mason Wood Walker, Inc., Universal Service Financial Analysis, June 25, 2004, at 5 [emphasis in original].

established in that order, however, requires the Commission to consider the *total* impact on the fund as a result of the waiver.[60]

Regardless of whether the expected impact on the fund will exceed one percent, however, the amount of per-line funding (approximately $14,000 per year and rising) combined with total annual support requested by SIC ($17.3 million per year and rising) deserves greater scrutiny than the much smaller funding levels that the Commission previously approved. Recent changes in Commission policy regarding universal service, spurred in part by growth of CETC funding and concerns over waste, fraud and abuse, indicate to even a casual observer that the Bureau should have applied greater scrutiny to the adverse effect the waiver would have on the universal service fund. The Bureau Order recognized this policy shift when it references the Commission's March 2005 order setting new standards for designating competitive eligible telecommunications CETCs.[61] In the *CETC Standards Order*, the Commission found for the first time that the amount of per-line support should be considered when weighing the public

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[60] *PTI/Eagle Order* at ¶ 14-15.

[61] Order at ¶ 17 (citing *Federal-State Joint Board on Universal Service*, Report and Order, CC Docket No. 96-45, FCC 05-46 at ¶ 55 (rel. Mar. 17, 2005) ("*CETC Standards Order*")). Moreover, the total amount of annual support that will be drawn by SIC in 2005 alone is quite large no matter what percentage of universal service support that it represents. Much has changed since the Commission set forth its "one percent" test. One percent of the universal service fund today is not what it used to be. For example, in the *PTI/Eagle Order*, the petitioner's $18.1 million draw on the universal service fund was calculated to have approximately a 2.5 percent impact on the universal service fund in 1993. In contrast, the Bureau estimated that SIC's similar draw on the universal service fund in 2005, $17.3 million, amounts to 0.42 percent. Much more in line with recent precedent are waiver applications that seek tens of thousands of dollars, not tens of millions of dollars. *See e.g. Killduff Order* at ¶ 10 (seeking $25,967 in high cost loop support); *Blackduck Order* at ¶ 4 (seeking $88,154 in high cost support); Pioneer Order at ¶ 7 (seeking an increase in support of $47,514).

interest implications of designating additional ETCs.[62] The Bureau's refusal to consider per-line support amounts here seems an omission that offends current Commission policy and is unsupported by the precedent on which the Bureau relies.[63]

In line with recent developments in the law, continuing concern about the size of the universal service fund, and the record evidence, the Commission should find that SIC's proposed demands on the fund will adversely affect the universal service fund.

2. The Bureau's public interest finding was not based on reasoned decision-making

The Bureau's public interest analysis hinges on Sandwich Isles' claims that it will use federal universal service funds to build facilities to new customers in the HHL. A public interest analysis, however, should investigate both the costs and benefits of granting the waiver.[64]

For example, even if the Bureau correctly concluded that the amount of requested funding would not have an adverse impact on the universal service fund, it was incumbent on the Bureau separately to consider whether providing SIC with approximately $14,000 per line serves the public interest.

The Bureau should have considered the precedent that the grant of the waiver would set. The vast majority of the area that SIC seeks funding to serve remains uninhabited. Sandwich Isles failed to explain how it serves the public interest to provide funding today for a network that it may have use for in the future. Nor did SIC establish how its qualifications to

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62 Order at ¶ 17 (citing *Federal-State Joint Board on Universal Service*, Report and Order, CC Docket No. 96-45, FCC 05-46 at ¶ 55 (rel. Mar. 17, 2005); *CETC Standards Order* at ¶ 55.

63 For example, the Skyline sought $71,000 in annual funding. *Skyline Order* at ¶ 15.

64 *See supra* note 29. The Bureau's public interest consideration of the study area waiver is far less exacting than the FCC's recently-enumerated criteria for obtaining a CETC designation. *See Federal-State Joint Board on Universal Service*, Report and Order, CC Docket No. 96-45, FCC 05-46 at ¶ 20 (rel. Mar. 17, 2005).

serve the HHL are superior to those of the ILEC. Indeed, Verizon made clear that, for less than SIC now demands, it was ready, willing and able to serve the HHL. This order is an invitation to other new entrants to make promises to states and then come to the FCC begging for support in order to fulfill those commitments. Verizon did not have access to support to serve these areas because the FCC's high-cost support rules classify the HHL as part of a non-rural study area entitled to no high-cost support.[65] Indeed, the Commission has made clear that it is not inclined to grant study area waivers to existing ILECs, in order to allow federal support for ILEC investment in unserved areas.[66]

The "special circumstances" at issue in this proceeding weigh heavily against granting the waiver. Such special circumstances include the fact that: (1) the study area waiver does not involve a sale of study area; (2) the ILEC opposes the waiver; (3) SIC seeks an unusually large amount of per-line and total support; and (4) SIC asserts an exclusive franchise in the affected area. The remaining aspects of the SIC Petition are all too common and appear to track the very concerns that underlie the Commission's very imposition of the study area freeze. The federal support will benefit very few customers in the HHL, yet greatly expand demand on the fund. A start-up company with no proven track record and publicly stated intentions of using the support outside the area for which it is intended gets support when the Commission's rules deny such support to the ILEC charged by the state with serving the area as a carrier of last resort.

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65 *See* USAC Quarterly Administrative Filing 2005, Third Quarter (3Q) Appendices, HC05, filed May 2, 2005, at http://www.universalservice.org/overview/filings (showing that Verizon Hawaii's study area receives no high-cost loop support).

66 *U.S. West and Gila River Telecommunications, Inc., Joint Petition for Waiver of the Definition of "Study Area" Contained in Part 36, Appendix-Glossary, of the Commission's Rules*, Memorandum Opinion and Order, 7 FCC Rcd 2161, at ¶ 11 (Com. Car. Bur. 1992).

It seems too result-oriented for the Bureau to cite as the main public interest benefit of this waiver that, if SIC receives federal universal service support, it will spend it. How this serves the public interest is a question begged by the Bureau's Order.

The Bureau states that it is required to decide whether providing universal service support to the petitioner will benefit the public interest, not "whether another party theoretically might provide a greater benefit."[67] By granting the waiver, however, the Bureau effectively is holding that SIC will provide a greater benefit than the ILEC, Hawaiian Telcom, or else it would not change the existing study area boundary and assign part of the HHL to SIC. Indeed, the bar should be quite high to demonstrate that the public interest would be served by taking territory away from an ILEC over the ILEC's opposition. The Bureau did not do this based on a state public utility commission finding that Verizon could not adequately serve the public. Rather, the Bureau compared highly subsidized SIC with an unsubsidized Hawaiian Telcom. The Bureau's Order establishes a dangerous precedent that can only be expected to open the floodgates to more petitions for special projects benefiting individual communities but turning the universal service funding mechanism upside down.

IV. CONCLUSION

For the foregoing reasons, the Commission should reverse the Bureau Order. Alternatively, the Commission should determine with more specificity the geographic boundaries of the new SIC study area and the regulatory rights and obligations of SIC and Hawaiian Telcom in the HHL. Of critical importance, the Commission should clarify that Hawaiian Telcom has the right to continue to serve the portions of the HHL already served by or

[67] Order at ¶ 22.

adjacent to areas served by Hawaiian Telcom and that SIC does not have an exclusive right to serve all of the HHL.

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CERTIFICATE OF SERVICE

I, Thomas A. Allen, hereby certify that on this 15th day of June, 2005, the foregoing "Application for Review" was served via first class mail, postage pre-paid, upon the following:

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